Acting NIO/Econ (David Low)
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Threat Outlook: Trade Problems Caused by Imbalances in the Japanese Economy

The disequilibrium between savings and investment in the Japanese economy will cause continuing friction with the United States. In economic terms, the failure of Japan's savings rate to decline in line with the slowdown in investment is forcing a large outflow of capital that depresses the yen and increases Japan's trade competitiveness.

-- Japanese families save roughly 20 percent of their income, but the demand for investment funds at home has declined as overall economic growth has fallen off and the economy has moved away from capital-intensive heavy industry.

-- In practical terms, this imbalance reflects the failure of Japan to shift gears from a drive for industrial superiority to a more balanced growth path giving higher priority to consumer spending.

-- Japanese policymakers still think in terms of the next target of opportunity for domestic investment;

-- This industrial growth approach is reflected in efforts to protect key high-tech industries such as computers and communications equipment including satellites.

While US policymakers tend to focus on the current trade imbalance as the primary problem caused by these outflows, we believe there are longer-term implications of this disequilibrium.

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- -- The existence of the savings surplus puts continuing pressure on Japan to foster new domestic investment--an export-oriented defense industry is an obvious new target for the late 1980s given the size of international demand and the technical capabilities of Japanese industry in dual-use goods.
- -- At the same time, lack of a robust consuming sector limits our ability to sell in Japan.
- -- Although growing relatively slowly, 50 to 60 percent of Japanese income is spent by private consumers.

Both Japanese and US policymakers agree that structural economic problems should be a topic for discussion in the OECD and at the Summit meeting this year.

- -- While the Japanese will argue that their fiscal deficit limits options to increase growth, several policies could be implemented to bolster consumer spending without worsening the deficit.
- -- Policies to limit tax breaks on savings and others aimed at increasing the supply of land for housing are two examples frequently cited by critics of current Japanese fiscal policy.